

May 13, 2005
Uniformity Meeting for Combined Reporting Proposal
May 13, 2005, 3:30 pm

Ted opens meeting

Roll call of participants

Ted Spangler, ID
Dick McFarland, ID
Wood Miller, MO
Roy Crawford, HellerEhrman
Phil Plant (CA attorney)
Mike Brownell, CA FTB
Larry Bobolis CA FTB
Gene Walborn, MT
Frank Hales, UT
Mary Loftsgard, ND
Joe Ellis
Scott Bry
Alice Ward, Argonaut
Art Vite, HCA, TN
Glancey, WV
Hall, ACLI
Mary Wilkin
Doug Lindholm, COST
Bob Bartaler, Prudential,
Mark Carter, ACLI
Kendal Houghton
Ferdinand H., PWC
Eric Smith, Oregon
Deloitte
Dianne Smith, COST
Gill, McNulty, Mike Wood, Mike Case, PA
Shirley Sicilian
Ken Beier
Elliott Dubin

Ted emphasized that there is not a lot of time in the current meeting to review the hearing officer's report and related issues, so that he would try to move things along quickly. He noted that Items II and III on the Agenda would be switched. In addition, he encouraged participants to focus on the items of greatest importance and to be concise in their comments. He explained that the Executive Committee has a short time frame on this issue and wants the committee to reach some kind of conclusion that allows for a bylaw 7 survey.

Shirley then reviewed comments on and changes to the proposal.

What entities make up the combined group?

The definition of a unitary business dovetails with the existing MTC definition—lots of industry comment on this. Some suggested the application of arms length pricing findings as a condition for combination—we think there is no rationale for this. We received a lot of good input on insurance—the original model called for combining all corps, including those who are not subject to an income tax. A small work group recommended to the committee that the model not require combination of all corporations, but require combination only of corporate income taxpayers. Combination of non-income taxpayers would be accomplished via regulation or on a case by case basis. This is a complicated process and perhaps needs to be considered on an industry by industry basis—there are issues with defining income and defining factors. The committee also notes that MTC could develop uniform regulations on this. The insurance industry issues have been taken into account with this compromise.

Waters Edge Election

We received comments on tax havens that “doing business in a tax haven” was overly broad. (Reference to comment on 5.a.7.i.) We made a change to reduce the director’s discretion with regard to tax havens. On page 8, we have excluded the tax haven entity if it appears that the jurisdiction does not come under the definition of tax haven. Commerce clause concerns were expressed about tax haven definition—I don’t think these are valid since this is an election by the taxpayer. In addition, since we are using an OECD definition, we are promoting “speaking with once voice” which is one of the prongs used to evaluate commerce clause violations. On page 2, the proposal clarifies that the tax haven definition is that appropriate to the year in question.

Subpart F Income

This clarifies that entities included on page 8 are included only to the extent of that [Subpart F] income. Another change—we are not including Subpart F income subject to a high tax rate—this removes the director’s discretion in this circumstance.

20% Threshold

Page 8 also clarifies that the 20% threshold is narrowed to intangible and passive income.

Initiation and Withdrawal

This was changed to make this a 10-year election—after that, it can be changed, or continues for another 10 years.

Method of Combination

In general, we treat the members of a unitary group as separate taxpayers. There is an exception for charitable deductions. Regarding NOLs, we did not change the separate treatment. This is consistent with use of the Joyce rule. On deferred intercompany transactions—we state that restored income will be treated as business income—the reason for this is that only business income is deferred.

Implications of Adopting the statute

We received a lot of comments on this, but they are outside the scope of the statute—this is briefly addressed in the hearing officer's report. For example, some stated that enactment of the statute would eliminate the need for throwback. —we don't think this is true. Throwback will be dealt with on a state-by-state basis and is outside the scope of this project.

Ted thanked Shirley for her comments, opened the floor to comments from taxpayers and taxpayer representatives, and encouraged the insurance representative to go first.

Dianne Smith

The insurance industry continues to be concerned about combination of insurance entities (not subject to income tax) with income taxpayers. These concerns come from the “real” insurance industry. [The implication here may be that distortion problems come from bad apples in the industry of from captive insurance situations.] The theory is that these issues can be dealt with via regulation. We think that there could be a little more about the nature of the technical problems in the hearing officer's report.

I'm hearing that there are trade associations or individual companies that would take this to individual states. If the MTC is interested in getting this adopted, then it should deal with this in the report. We suggest that this is only the beginning of this discussion—there are many issues about whether this can be done and how.

Jim, ACLI

Thanked the MTC for listening to our concerns—most main line insurers don't do this [engage in distortions]—we think that a case by case basis [for combination] is preferable—only an extreme minority is doing inappropriate avoidance. Combination of insurance companies with income taxpayers would involve a lot of new and interesting issues.

Bob Monteleon, Prudential

We have two separate [tax] regimes for insurance and corporations subject to the income tax. At some time, you'll be reaching out to insurance departments on this—we need to have a dialog between departments of revenue and department of insurance.

Ted—let's move on to water's edge election and tax havens.

Kendall Houghton

The hearing officer's report was excellent on this—Jeff Friedman and I had considerable comments—I think you received a fair amount of comment—that “doing business in a tax haven” is difficult to interpret—regarding the hearing officer's report on the use of U.S. constitutional standard for “doing business”—I don't think this is any easier to apply in a tax haven than it is in the states. The “doing business” standard currently varies among the states—SC & NC might view “doing business” as sales into a jurisdiction—for TN and others, physical presence would be important—I was hoping that in a supplemental report, you could suggest some alternatives to the doing business standard—this might be an opportunity to introduce your factor presence proposal—we would like further examination of this and would like some further discussion on this.

Jeff Friedman

I'd like to be on record that just because something is an election, doesn't eliminate constitutional issues. We still think that picking good and bad countries is a violation of the Commerce Clause.

Dianne Smith (speaking on behalf of COST).

COST supports the Sutherland Asbill approach on this--to the extent that it [the concerns] is not domestic companies and domestic income. We recognize that there have been some high profile cases here—and there has been improper tax planning—we understand what the MTC is seeking here; however, there is a clear bias here that taxpayers are going to be doing something wrong. To the extent that this bias can be removed—that would get rid of a lot of the controversy accompanying this section of the proposal.

Roy Crawford on Credits

The proposal is slightly off the mark on this—the proper analysis is--when one is a member of a combined group that generates a credit, examine whether this activity is related to the unitary business and apportionable income. Typically a credit results in the reduction in the cost basis of an asset. The credit should be spread to the unitary group in the same manner that a depreciation deduction is spread to the unitary group. There is no reason to depart from the unitary concept simply because it is a credit.

Dianne Smith commented that this was the number one issue that we received comments on from members of COST. She then reiterated the position of providing similar treatment for depreciation and credits. She stated that the default, instead of restricting the credit to the member, should be application of the credit to the entire group. That is, the default is going the wrong way. She also noted that there have been a lot of briefs filed in CA on credits—on both sides—I encourage the committee to take a look at those briefs before you reach a final decision.

Dianne acknowledged that the hearing officer did listen to “us” and make changes that we appreciate, such as the time limit on the election, and treatment of U.S. affiliates and thanked the committee for these changes.

Following a brief summary of industry comments, Ted asked for comments from the States. Mike Brownell of CA commended Shirley for her efforts to drive this through a number of icebergs .He explained that the states are not all together on some of these issues. For example, CA is concerned about combination with insurance companies and the end result gives us time to consider this. Regarding credits—we don’t think that credits are unitary—we support the MTC position on this. Regarding tax havens—the language here works out most of the kinks we were concerned about.

Gene Walbourn of MT noted that most states on the call are unitary, and that he had not had much time to discuss the combined reporting issues with his director. This perspective was echoed by Frank Hale of UT.

Ted asked if there was any non-concurrence with the hearing officer, as expressed in the report. There was none.

Ted asked if any state expressed an objection to concurrence with the hearing officer’s recommendation. MT responded that it concurred, but might want further discussion on insurance. CA responded that the hearing officer’s report is excellent and provides a difficult compromise on a number of issues.

In response to a question from Ted, Shirley confirmed that there will be a supplemental hearing officer’s report.

Jeff Friedman asked if there would be an opportunity to make additional written comments. Ted answered that the supplemental report will go to the MTC Executive Committee fairly soon—and that there would be an opportunity for comments, including written comments, at that time.

In response to a question from Mr. Hall (ACLI) said the Executive Committee would review this by teleconference within the next 14 days.

Ted thanked all for participating and the meeting was adjourned at 4:53 pm.